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# In the Supreme Court of the United States

OCTOBER TERM, 1959

No. 236

STERN & STERN TEXTILES, INC. (SUCCESSOR IN INTEREST TO HUGUET FABRICS CORPORATION), PETITIONER

*v.*

COMMISSIONER OF INTERNAL REVENUE

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT*

## BRIEF FOR THE RESPONDENT IN OPPOSITION

### OPINIONS BELOW

The opinion of the Tax Court (Pet. 10a–17a) is reported at 26 T.C. 1000. The opinion of the Court of Appeals (Pet. 4a–9a) is reported at 263 F. 2d 538.

### JURISDICTION

The judgment of the Court of Appeals (Pet. 3a) was entered on February 2, 1959. A petition for rehearing was denied (Pet. 2a) on March 23, 1959. The petition for certiorari was filed on July 21, 1959, to which date the time for filing had been extended by an order (Pet. 1a) by Mr. Justice Harlan on June 15, 1959. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

## QUESTION PRESENTED

Whether the Court of Appeals was correct in affirming the Tax Court's holding that, upon the facts here, by reason of the Tax Court's decision on the merits in a prior case denying the taxpayer's claim for excess profits tax relief under Section 722 of the Internal Revenue Code of 1939 with respect to its fiscal year 1941, the taxpayer was barred by the doctrine of collateral estoppel from again litigating upon the same grounds in these proceedings its claims for relief under Section 722 with respect to its fiscal years 1942 through 1946.

## STATUTE INVOLVED

The pertinent provisions of Sections 722 and 732 of the Internal Revenue Code of 1939 are set forth in the Appendix, *infra*, pp. 11–14.

## STATEMENT

In these proceedings (later consolidated (Pet. 11a)), the taxpayer [1] sought a redetermination of the Commissioner's disallowance of its applications for excess profits tax relief under Section 722 of the Internal Revenue Code of 1939 with respect to its fiscal years ended September 30, 1942 through 1946. Hearing the cases upon the severed issue of collateral estoppel, the Tax Court held that, under that doctrine, the taxpayer was precluded from re-litigating on the merits in these proceedings its right to Section 722 relief as to its fiscal years 1942 through 1946, by reason of the final decision on the merits in a prior case,

[1] The term "taxpayer" refers also, when applicable, to the taxpayer's predecessor in interest, Huguet Fabrics Corporation.

*Huguet Fabrics Corp.* v. *Commissioner*, 19 T.C. 535,[2] holding that the taxpayer was not entitled to any Section 722 relief, upon identical grounds, with respect to the fiscal year 1941. (Pet. 10a-17a.)

In the Tax Court, the taxpayer "narrowed" (Pet. 12a) its defense to the collateral estoppel plea to the single contention that there was a difference in the "controlling facts" of the prior case and those of the instant cases[3]—the taxpayer claiming that the prior case had "turned" (Pet. 14a) upon an alleged "mutual mistake" (Pet. 12a) as to one factual detail[4] in a stipulation of facts in the prior case.[5] The Tax Court, assuming

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[2] That opinion supplanted, upon reconsideration, an earlier opinion of the Tax Court, likewise adverse to the taxpayer, *Huguet Fabrics Corp.* v. *Commissioner*, 18 T.C. 605.

[3] All other requirements for the application of collateral estoppel were satisfied, the Tax Court pointed out (Pet. 11a-12a), since the identity of the parties was stipulated, the identity of issues was not challenged, and no change in the applicable legal rules had intervened. The taxpayer's position against the application of collateral estoppel was similarly limited in the Court of Appeals to the contention that there was a change in the controlling facts. (Pet. 6a.)

[4] Namely, in the tabulation of the taxpayer's monthly statistics of sales to customers (Exhibit 6-F (Pet. 29a)) the amount of sales to one (the Cohen concern) in the month of September, 1940.

[5] The taxpayer's effort (Pet. 27-28) to charge the Commissioner with responsibility for the alleged error, apparently on the theory that the "incorrect stipulation was asked for" (Pet. 27) or "requested" (Pet. 7) by the Commissioner, is contrary to the evidence. Testimony of one of the taxpayer's own witnesses disclosed that the information which was in the stipulation in the prior case had been originally furnished by the taxpayer's counsel to the Commissioner's counsel, and that the latter merely prepared the draft of the proposed stipulation, and the document which became Exhibit 6-F, attached to the stipulation (and which document contained the alleged error (Pet. 10-11)), was actually a photostatic copy of one of several schedules (containing facts presumably ac-

(without deciding) that the taxpayer's evidence adduced at the hearing in these proceedings established the alleged error in the stipulation in the prior case (Pet. 14a), nevertheless decided adversely to the taxpayer because it concluded that the decision against the taxpayer in the prior case had not in fact turned upon that one "bit of evidence" (Pet. 15a), but had instead been grounded upon a failure of proof on the part of the taxpayer, i.e., upon the failure of the taxpayer to meet its burden of establishing that its base period earnings were an inadequate standard of normal earnings and of establishing the existence of "ultimate facts" which would justify the granting of Section 722 relief (Pet. 14a–16a).

The Court of Appeals affirmed (Pet. 4a–9a),* concluded

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curately taken from the taxpayer's records) submitted by the taxpayer, through its counsel, to the Commissioner. (See unprinted Transcript of Hearing before the Tax Court in these proceedings, pp. 48–49, 54, 55–58.)

* Adhering to its prior holding in *George Kemp Real Estate Co.* v. *Commissioner*, 205 F. 2d 236, certiorari denied, 346 U.S. 876, the Court of Appeals held that it had jurisdiction to review the decision of the Tax Court "despite the provisions of § 732(c)" of the 1939 Code. (Pet. 5a.) The Commissioner had suggested that, in the light of more recent cases—see *Standard Hosiery Mills* v. *Commissioner*, 249 F. 2d 469 (C.A. 4th); *Brown Paper Mill Co.* v. *Commissioner*, 255 F. 2d 77 (C.A. 5th), certiorari denied, 358 U.S. 906, rehearing denied, 358 U.S. 942; *Patent Button Co.* v. *Commissioner*, 256 F. 2d 726 (C.A. 6th); *Crowell-Collier Pub. Co.* v. *Commissioner*, 259 F. 2d 860 (C.A. 2d), certiorari denied, 358 U.S. 928; and *Bradford Machine Tool Co.* v. *Commissioner*, 260 F. 2d 950 (C.A. 6th); see also *Helms Bakeries* v. *Commissioner*, 263 F. 2d 642 (C.A. 9th), certiorari denied, 360 U.S. 903, petition for rehearing filed July 1, 1959—there was at least a serious doubt as to jurisdiction, since the sole issue in these proceedings was as to the taxpayer's right to relief under Section 722, and the determi-

ing that (Pet. 9a) collateral estoppel was plainly applicable since "the parties, the issue, the 'controlling' facts and the applicable law are all the same as in the earlier litigation".

## ARGUMENT

The courts below correctly refused to allow the taxpayer to litigate again in these proceedings as to later years the identical matter—i.e., the right to excess profits tax relief under Section 722, upon the same ground under subsection (b)(4)—decided on the merits adversely to the taxpayer in an earlier case as to a prior year. See *Commissioner* v. *Sunnen*, 333 U.S. 591; *Tait* v. *Western Md. Ry. Co.*, 289 U.S. 620; and *Cromwell* v. *County of Sac*, 94 U.S. 351; cf., *United States* v. *International Building Co.*, 345 U.S. 502, rehearing denied, 345 U.S. 978. See also *George Kemp Real Estate Co.* v. *Commissioner*, 17 T.C. 755, affirmed, 205 F. 2d 236 (C.A. 2d), certiorari denied, 346 U.S. 876, and *Jacob's Fork Pocahontas Coal Co.* v. *Commissioner*, 24 T.C. 60, in which the doctrine of collateral estoppel was applied in cases involving claims for Section 722 excess profits tax relief. The decision below constitutes nothing more than an application to the particular facts of this case of well settled principles as to the role in tax cases of the doctrine of collateral estoppel or estoppel by judgment. There is no conflict of decisions and the case presents no question warranting review by this Court.

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nation of the collateral estoppel question could well be regarded as made "necessary solely by reason of * * * section 722", so as to make the prohibition of Section 732(c) applicable.

1. The decision below is not, as urged (Pet. 14, 15–18), contrary to the decision of this Court in *Commissioner* v. *Sunnen, supra*. Since the matter here sought to be litigated again was identical to that decided in the prior case and the identity of the parties was stipulated, and since no change had intervened in the applicable legal rules or controlling facts, the decision below is entirely consistent with *Sunnen*, and is upon the facts unquestionably correct.

The sole contention made by the taxpayer, both in the Tax Court (Pet. 12a) and in the Court of Appeals (Pet. 6a), was that there was a difference between the "controlling facts" of the first case and those of the instant cases. Upon careful and extensive analysis, the Tax Court rejected that contention (Pet. 12a–17a), and the Court of Appeals, expressly pointing to the careful consideration by the Tax Court (Pet. 6a), correctly affirmed (Pet. 6a–9a).

The taxpayer's additional contention (Pet. 18–20), made for the first time in this Court (cf., Pet. 6a, 12a), to the effect that a "change in the legal climate" (Pet. 18) had intervened after the decision of the prior case, is wholly without merit. As the Tax Court correctly pointed out (Pet. 12a), "there has been no change in the legal rules applicable in section 722 cases"—no change has been introduced either in the statute, the applicable regulations, or the decided cases. The decision in *Davenport Hosiery Mills, Inc.* v. *Commissioner*, 28 T.C. 201, to which the taxpayer points (Pet. 19), presents merely a factual conclusion that, upon the facts there shown, a change from silk to nylon hosiery was to

be regarded as revolutionary—but cannot be construed as reflecting any change whatsoever in the legal rules applicable in Section 722 cases.[7]

2. The argument to the effect that (Pet. 14, 22–24) there should have been a review by the Special Division of the Tax Court, in keeping with Section 732(d) of the 1939 Code (Appendix, *infra*, p. 14), is without merit. It rests upon the theory (see Pet. 23) that the judge (or "division") of the Tax Court who heard the instant case "decided this case on its merits." That theory is obviously inconsistent with the taxpayer's efforts to obtain a review in the Court of Appeals,[8] for Section 732(c) would bar a review of a denial on the merits of relief under Section 722.[9] Significantly—although the taxpayer had made a request in the Tax Court for a review by the Special Division (Pet. 31a–33a), which had been denied (Pet.'s C.A. App. 3, 6, 9, 11)—the point was not raised in the Court of Appeals (cf., Pet. 6a) until the taxpayer filed its peti-

[7] There is no conflict, as urged (Pet. 14, 20–21), as to the question of collateral estoppel in tax cases, with *Parker* v. *Westover*, 221 F. 2d 603 (C.A. 9th). That case represents a situation in which the Court of Appeals concluded, unlike the courts below in the instant case, that upon the circumstances there shown there had been a "change" in the "complexion of the significant facts" (221 F. 2d, at p. 606) sufficient to lift the bar of collateral estoppel.

[8] In the Court of Appeals, the taxpayer (in its opening brief, p. 3) made six separate assignments of error specifically charging the Tax Court with refusing to permit the instant cases to be tried on their merits, and it concluded its opening brief and its reply brief, respectively, with prayers to the effect that these cases should "go to trial on the merits" and that the Court of Appeals should "order the cases * * * to be heard on their merits."

[9] Cf., footnote 6, *supra*.

tion for rehearing, in which, for the first time, it argued to the Court of Appeals (amongst other things) that the Tax Court had erred in deciding these cases on the merits without a review by the Special Division.

3. The point (Pet. 14, 24–27) that the Tax Court did not have power or authority to apply the doctrine of collateral estoppel, raised for the first time in this Court, is also without merit. No restrictions or limitations of any sort are placed upon the Tax Court, as the adjudicating tribunal, in the statute conferring jurisdiction upon it to review the Commissioner's disallowance of Section 722 relief claims, Sections 732 (a) and (b) of the 1939 Code (Appendix, *infra*, pp. 13–14).

4. Likewise without merit is the contention (Pet. 14, 28–35) that the Court of Appeals departed from the issues before it, in sustaining the Tax Court in these cases. That argument appears to rest primarily upon an incorrect interpretation of the real substance of the opinion of the Court of Appeals.

The affirmance of the Tax Court by the Court of Appeals was premised upon a recognition (Pet. 6a) that the Tax Court had given careful consideration to the taxpayer's contention that there was a difference in the "controlling" facts by reason of the alleged mutual mistake in the stipulation in the prior case; that the Tax Court had concluded that the "bit of evidence" allegedly introduced in error by the prior stipulation would not (even assuming it to be wrong) have produced a different result in the prior case; and that the Tax Court, upon analysis of the prior

case, had concluded that the denial of Section 722 relief had been upon the broader basis that the taxpayer "had not introduced sufficient evidence" to establish a "qualifying" change in the character of its business under Section 722(b)(4). Thus, the Court of Appeals indicated complete satisfaction with the Tax Court's analysis of the taxpayer's contention as to the effect of the alleged error in the stipulation in the prior case and with the conclusion reached by the Tax Court. (Pet. 6a.) Moreover, the Court of Appeals (Pet. 6a–7a) made its own examination of the prior case, and reached the same conclusion. In the course of that discussion, the Court of Appeals stated that, if the alleged error were of such character as would require a finding in this case in favor of the taxpayer (i.e., a finding that the taxpayer, within the meaning of Section 722(b), had changed the character of its business during the base period, and that its base period earnings did not reflect the normal operation for the entire base period), it would favor a reversal. However, the court concluded that the alleged error "was purely incidental and of no consequence." (Pet. 7a–8a.)[10]

[10] The reference (Pet. 8a) by the Court of Appeals, amongst other things, to the lack of evidence establishing "temporary circumstances" depressing the business during the base period—to which the taxpayer now points (Pet. 32–33) as a matter falling not under Section 722(b)(4), but under Section 722(b)(2)—may have been unnecessary, since the taxpayer no longer relied (Pet. 32) on Section 722(b)(2). Nevertheless, this is of no consequence, since, even without or aside from the reference to "temporary circumstances", the decision below would remain a correct application of the doctrine of collateral estoppel.

## CONCLUSION

For the foregoing reasons, the petition should be denied.

Respectfully submitted.

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AUGUST 1959.

## APPENDIX

Internal Revenue Code of 1939:

SEC. 722 [as added by Section 201 of the Second Revenue Act of 1940, c. 757, 54 Stat. 974, and as amended by Section 222 of the Revenue Act of 1942, c. 619, 56 Stat. 798, and the Act of December 17, 1943, c. 346, 57 Stat. 601]. GENERAL RELIEF—CONSTRUCTIVE AVERAGE BASE PERIOD NET INCOME.

(a) *General Rule.*—In any case in which the taxpayer establishes that the tax computed under this subchapter (without the benefit of this section) results in an excessive and discriminatory tax and establishes what would be a fair and just amount representing normal earnings to be used as a constructive average base period net income for the purposes of an excess profits tax based upon a comparison of normal earnings and earnings during an excess profits tax period, the tax shall be determined by using such constructive average base period net income in lieu of the average base period net income otherwise determined under this subchapter. * * *

(b) *Taxpayers Using Average Earnings Method:*—The tax computed under this subchapter (without the benefit of this section) shall be considered to be excessive and discriminatory in the case of a taxpayer entitled to use the excess profits credit based on income pursuant to section 713, if its average base period net income is an inadequate standard of normal earnings because—

* * * * *

(4) the taxpayer, either during or immediately prior to the base period, commenced business or changed the character of the business

and the average base period net income does not reflect the normal operation for the entire base period of the business. If the business of the taxpayer did not reach, by the end of the base period, the earning level which it would have reached if the taxpayer had commenced business or made the change in the character of the business two years before it did so, it shall be deemed to have commenced the business or made the change at such earlier time. For the purposes of this subparagraph, the term "change in the character of the business" includes a change in the operation or management of the business, a difference in the products or services furnished, a difference in the capacity for production or operation, a difference in the ratio of nonborrowed capital to total capital, and the acquisition before January 1, 1940, of all or part of the assets of a competitor, with the result that the competition of such competitor was eliminated or diminished. Any change in the capacity for production or operation of the business consummated during any taxable year ending after December 31, 1939, as a result of a course of action to which the taxpayer was committed prior to January 1, 1940, or any acquisition before May 31, 1941, from a competitor engaged in the dissemination of information through the public press, of substantially all the assets of such competitor employed in such business with the result that competition between the taxpayer and the competitor existing before January 1, 1940, was eliminated, shall be deemed to be a change on December 31, 1939, in the character of the business, or

* * * * *

(d) *Application for Relief Under This Section.*—The taxpayer shall compute its tax, file its return, and pay the tax shown on its return under this subchapter without the application of this section, except as provided in

section 710(a)(5). The benefits of this section shall not be allowed unless the taxpayer within the period of time prescribed by section 322 and subject to the limitation as to amount of credit or refund prescribed in such section makes application therefor in accordance with regulations prescribed by the Commissioner with the approval of the Secretary. If a constructive average base period net income has been determined under the provisions of this section for any taxable year, the Commissioner may, by regulations approved by the Secretary, prescribe the extent to which the limitations prescribed by this subsection may be waived for the purpose of determining the tax under this subchapter for a subsequent taxable year.

* * * * *

(26 U.S.C. 1952 ed., Sec. 722.)

SEC. 732 [as added by Section 9 of Excess Profits Tax Amendments of 1941, c. 10, 55 Stat. 17, and as amended by Section 222(c) of the Revenue Act of 1942, *supra*, by Section 2 of the Joint Resolution of June 30, 1945, c. 211, 59 Stat. 295, and by Section 203(a) of the Act of December 29, 1945, c. 652, 59 Stat. 669]. REVIEW OF ABNORMALITIES BY THE TAX COURT OF THE UNITED STATES.

(a) *Petition to the Tax Court.*—If a claim for refund of tax under this subchapter for any taxable year is disallowed in whole or in part by the Commissioner, and the disallowance relates to the application of section 711(b)(1)(H), (I), (J), or (K), section 721 or section 722, relating to abnormalities, the Commissioner shall send notice of such disallowance to the taxpayer by registered mail. Within ninety days after such notice is mailed (not counting Saturday, Sunday, or a legal holiday in the District of Columbia as the ninetieth day) the taxpayer may file a petition with the

Tax Court of the United States for a redetermination of the tax under this subchapter. If such petition is so filed, such notice of disallowance shall be deemed to be a notice of deficiency for all purposes relating to the assessment and collection of taxes or the refund or credit of overpayments.

(b) *Deficiency found by the Tax Court in case of claim.*—If the Tax Court finds that there is no overpayment of tax in respect of any taxable year in respect of which the Commissioner has disallowed, in whole or in part, a claim for refund described in subsection (a) and the Tax Court further finds that there is a deficiency for such year, the Tax Court shall have jurisdiction to determine the amount of such deficiency and such amount shall, when the decision of the Tax Court becomes final, be assessed and shall be paid upon notice and demand from the collector.

(c) *Finality of Determination.*—If in the determination of the tax liability under this subchapter the determination of any question is necessary solely by reason of section 711 (b)(1) (H), (I), (J), or (K), section 721, or section 722, the determination of such question shall not be reviewed or redetermined by any court or agency except the Tax Court.

(d) *Review by Special Division of the Tax Court.*—The determinations and redeterminations by any division of the Tax Court involving any question arising under section 721(a)(2)(C) or section 722 with respect to any taxable year shall be reviewed by a special division of the Tax Court which shall be constituted by the presiding judge and consist of not less than three judges of the Tax Court. The decisions of such special division shall not be reviewable by the Tax Court, and shall be deemed decisions of the Tax Court.

(26 U.S.C. 1952 ed., Sec. 732.)

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